CHAPTER - I

INTRODUCTION

Industrialisation has a major role to play in the economic development of the undeveloped countries. The Government of India launched the process of industrialisation as conscious and deliberate policy of economic growth in early fifties. Indian Government recognised the significant contribution that industrialisation could make to the development process, "as a base for the growth of the primary sector, as a catalytic agent for the development of infrastructure, as a stimulant to generation of technologies through R&D effort.... and as a growth multiplier."

The financial performance of public limited companies showed significant improvement in the performance during the year 2006-07 compared to the performance of 1998-99 as revealed from the growth rates in respect of sales, value of production, gross fixed assets, long-term sources of finance and gross profit etc.

The total sales from the samples of selected companies amounting to Rs.11,80,089 crore, registered a growth of 26.5 per cent in 2006-07 as against 7.2 per cent in 1998-99. Value of production also recorded a growth
of 26.6 per cent in 2006-07 as against 6.4 per cent in 1998-99. The growth in Gross Profit rose by 44.7 per cent in 2006-07 from (-2.9) per cent in 1998-99.

The gross profit margin (gross profit as percentage of sales) of the selected sample companies remained constant at 11.0 per cent in 1998-99 and 1999-00, then it continued to increase from 12.2 per cent in 2004-05 to 12.4 per cent in 2005-06 and further to 14.2 per cent in 2006-07. On the other hand, the effective tax rate continued to decrease from 31.8 per cent in 1999-001 to 24.6 per cent 2005-06 and further to 24.0 per cent in 2006-07.

The total earnings in foreign currencies’ of the selected companies improved by 39.6 per cent to Rs.3,03,388 crores in 2006-07 as against 4.6 per cent recorded in 1998-99. The merchandise export valued at Rs.2,23,319 crore, grew by 41.9 per cent in 2006-07 as compared to 4.1 per cent growth recorded in 1998-99.

Total assets of the selected companies increased to 28.4 per cent in 2006-07 as against 8.4 per cent in 1998-99. Growth in gross fixed assets registered 17.8 per cent in 2006-07 as against 8.8 per cent in 1998-99.

The share of reserve and surplus in total liabilities increased marginally to 35.3 per cent in 2006-07 from 8.8 per cent in 1998-99. Debt equity ratio marginally increased to 47.3 per cent in 2006-07, which decreased to 46.8
per cent in 2005-06 from 70.7 per cent in 1998-99. The share of net fixed asset in total assets marginally declined to 39.5 per cent in 2006-07 from 48.8 per cent in 1998-99. On the other hand, the share of 'Inventories' and investment in total assets moved up to 11.0 per cent and 16.3 per cent in 2006-07 as compared to 12.2 per cent and 8.4 per cent in 1998-99. The current ratio remained unchanged at 1.2 per cent in 2006-07 as in 1998-99.

The total funds sourced and used by the selected companies amounted to Rs.3,45,254 crores in 2006-07 recorded a growth of 73.2 per cent over Rs.41,475 crore in 1998-99. Borrowings (32.4 per cent) followed by Reserve & Surplus, (24.8 per cent) were the major sources of funds. The share of borrowings in total sources of funds significantly declined from 37.5 per cent in 1998-99 to 32.4 per cent in 2006-07. In the absolute term borrowings amounted to Rs.1,11,745 crore during 2006-07 registered an increase of 61.8 per cent from Rs.15546 crore during 1998-99. The share of sundry creditors in total sources of funds increased to Rs.40,003 crore during 2006-07 from 1606 crores in 1998-99. The gross fixed assets formation by the selected companies increased to Rs.1,29,097 crore during 2006-07 from Rs.24,455 crore in 1998-99. But its share in total uses of funds decreased to 37.4 per cent in 2006-07 from 59.0 per cent, in 1998-99. Trade dues and current liabilities accounted for 19.9 per cent of total sources of funds in 2006-07 as compared to 12.8 per cent in 1998-99.
Companies in 'Sugar' and 'Cotton Textile' industries showed decline in their gross profit by 3.4 per cent and 3.9 per cent respectively 2006-07 as compared to (36.0 per cent) and (-25.1 per cent) in 1998-99. Construction industries increased their bank borrowings by 127.5 per cent in 2006-07 as compared to 31.6 per cent in 1998-99.

Companies in Pharmaceuticals (22.2 per cent), Cement (22.8 per cent), Construction industries (19.6 per cent) and Computer (23.7 per cent) revealed continued improvement in profit margin in 2005-06 as well as 2006-07 as compared to 12.3 per cent, 7.3 per cent, 9.9 per cent, 21 per cent respectively 1998-99. The debt equity ratio was significantly high in cotton textile 131.7 per cent in 2006-07 as compared to 78.5 per cent in 1998-99. Higher tax rate was registered for Engineering and Construction and lower tax rate was registered for Computer, Sugar and Pharmaceutical industries.

1.1 Relevance of the Study

This is a study of broad trends and analyses of financial structure relationships of the selected Joint Stock companies in India during the period 1997-98 to 2006-07. A very important element of financial analysis is the collection of statistical data and its use in measuring financial variables and testing financial relationship.
The significance of industrial sector in Indian economy has grown considerably for reaching changes which have taken place in industrial economy of the country. Not only has there been growth and diversification in the industrial complex but the industrial structure has become more balanced. Rising trend is noticed in the growth of sales. There have been considerable changes in asset structure and profitability of the Public Limited Companies which is equally responded by the changes in capital structure.

Industrial growth, however, has not been uniform since 1951. After a steady growth of about 8 percent during the initial period of 14 years (1951 to 1965), there was a fluctuating trend since then – near stagnancy during 1966-68, a high level of 9.5 percent during 1976-77, a minus 1.4 percent 1979-80. In the sixties (1961-70) the average growth rate of industrial output was at 5.5 percent and in the seventies (1971-80) the average growth rate was about 4 percent per annum. Even during 1980-85, the growth rate of industrial production was 5.5 percent per annum. The basic fact was that the rate of industrial growth had been slowing down. During the 7th Plan (1985-90), the growth rate had picked up to an average of 8 percent per annum and in 8th Plan, it had declined to 7.1 percent per annum. From 1991-92 to 2002-03 the average annual growth rate has been 11.7 percent. In the year 2003-04 and 2004-05 the growth rate is 15.7 and 24.6 percent. Last in the year 2005-06 and 2006-07 the growth rate is increased 17.9 to 26.5 percent. Say from 2003-04 to 2006-07 average annual growth is 21.175 percent.
Finance is broadly concerned with the acquisition of funds and their effective utilization. It is widely, of course, to cover the instruments, institutions and practices through which funds are obtained. It also covers the legal and accounting relationship between a Company and its sources of funds.\(^1\) Industrial finance, needed by industries irrespective of the period for which they are made available. Industries require long term funds to finance fixed assets like land and buildings, plants and machinery, furniture and equipments etc. Companies require such funds right from the stage of setting up, to the stage of running and maintaining it. Without it, no production is conceivable. Any expansion, modernization or diversification of the Companies also requires the long term funds for financing the fixed assets and short term sources to finance current assets.

However, the Companies cannot start functioning with the help of fixed assets alone. They acquire certain other assets like raw materials, stock of finished goods and sufficient cash to meet day-to-day expenditure. Funds required to meet these expenditures form a part of working capital. The adequacy of the amount of working capital provides the necessary stability to the business and enables it to continue its production unhampered.

Both long term and short term funds are required by the industries which can be arranged from the sources such as ploughing back of profits,
issue of shares and debentures, loans from special financial institutions and commercial banks, trade credit, public deposits, bank overdraft, installment credit and cash credit etc. The raising of funds is a difficult task in India as rightly observed by Hunt, William and Donaldson.\textsuperscript{2} “The savings of the community are the basic source of long term finance for the Corporations which in a country like India are not easily forthcoming. In less developed countries like India, the problem of raising funds for private industrial development is further complicated due to long standing preference on the part of the many, those who have been able to save and accumulate capital for investment in gold, precious jewels, real estate or other material wealth rather than in the intangibles such as stocks and bonds of the Corporations.”

Finance is concerned with procurement of funds and their effective utilization. Of course it covers the instruments, institutions and practices through which funds are obtained. It also covers the legal and accounting relationship between a company and its source of funds. Industrial finance, in its broad connotations, refers to the provision of finance needed by industries irrespective of the period for which they are made available. Industries require long term funds to finance fixed assets like land and building, plant and machinery, furniture and equipments etc. Any expansion, modernization or diversification of the company requires the long term funds for financing the fixed assets.
Both long term and working capital funds are required by the industries which can be arranged from the sources such as profits, issue of share and debentures, loans from financial institution and commercial banks, trade credit, public deposit, cash credit etc.

1.2 **Objective of the Study**

This study sets the following objectives taking into consideration the aim and research problem :

1. To identify trends in investment in fixed assets, current asset, long and short-term sources of finance and growth of sales;

2. To study profitability and liquidity of Joint Stock Companies in India;

3. To analyse the corporate financial structure relationships.

1.3 **Data Sources and Methodology**

The present study covers yearly data from 1997-98 to 2006-07. For the analysis of this study data has been collected both from primary and from secondary sources. The secondary data has been collected from the Stock Exchange official directory, Bombay, Reserve Bank of India bulletins, Reports of Industrial Development Bank of India (IDBI), special reports of Centre for
Monitoring Indian Economy (CMIE) and various web sites. Supplementary information was also sought through personal interviews and correspondence as primary data.

A sample of 1397 public limited manufacturing companies has been selected after scanning a large number of companies on the basis of their paid-up capital of more than 10 crores during 2006-07. The sample companies belong to 10 different industries are: Sugar, Cotton, Paper, Cement, Construction, Engineering, Chemical, Pharmaceutical, Electrical and Computer Industries.

Data has been tested and analysed through financial techniques like Trends, Ratios, Funds Flow Analysis. A computer based study through correlations, stepwise multiple regression analysis and 'F' test ratio has been made for analyzing the determinants of external funds, investment in fixed assets and inventories and gross profits of sample companies. The Software like Statistical Package for Social Science (SPSS 13.0), database, Database for data organization, MS-Excel for processing and generating the graphs/charts have been used. Trends and ratios have been estimated on the basis of X-12 ARIMA methodology, developed by US Bureau of Census, USA. Each of the techniques has been described in detail in chapter three.
1.4 Limitation of the Study

The study is based on the secondary data collected from the annual report of the stock exchange official directories, Bombay, Report on currency and finance and RBI bulletins of RBI, Reports on Development Bank of India of IDBI quarterly statistics of controller of capital issues. Hence the limitations prevailing with secondary data have been found in the study. Financial statements continue to be the major source of data for both macro & micro analysis of financial behavior of industrial companies. Further size and number of sample industries may slightly differ from the whole industry data.
1.5 Plan of Study

Following the Introductory chapter wherein the relevance of the study set up of the research problem and its scope, objectives and limitations have mentioned. In Chapter-II, The Indian Financial System has been presented. In Chapter-III, the Theoretical Frame Work adopted in study has been presented. In Chapter-IV, this has been followed by the Trend Analysis. In Chapter-V, the financial ratio has been analysed. Funds Flow Analysis has been described in Chapter-VI. Statistical Analysis has been made in Chapter-VII. The Summary of Finding of the study together with Conclusion has been reflected in Chapter-VIII.
References:


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